United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

Signed

76-4134

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

ESTATE OF JOSEPH VATTER, DECEASED,
ANNA VATTER, EXECUTRIX,

Appellee

v.

COMMISSIONER OF INTERNAL REVENUE,

Appellant

ON APPEAL FROM THE DECISION OF THE

UNITED STATES TAX COURT

BRIEF FOR THE APPELLANT

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STATEMENT OF THE ISSUE PRESENTED

Whether the Tax Court erred in holding that the decedent's estate was entitled to deduct as an administration expense expenses incurred in selling two improved parcels of real estate, where the realty was sold at the request of the testamentary trustee and the proceeds of sale were not necessary to pay decedent's debts, the expenses of administration and taxes.

STATEMENT OF THE CASE

This is an appeal by the Commissioner of Internal Revenue from a decision of the United States Tax Court, involving claimed federal estate tax deductions in the amount of $4,642.68, representing real estate sales commissions and expenses.[1/] (R. 11.)[2/] The opinion of the Tax Court, filed December 31, 1975, is reported at 65 T.C. 633. (R. 67-80.) The Tax Court entered its decision in favor of the estate on February 17, 1976. (R. 81.) The Commissioner's notice of appeal was timely filed on May 13, 1976. (R. 83.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

The material facts, as stipulated by the parties (R. 20-66), and as found by the Tax Court (R. 68-73), may be summarized as follows:

Joseph Vatter (decedent) died testate on May 5, 1968, a resident of Rochester, New York. Decedent's last will and testament nominated and appointed his wife, Anna Vatter, to be executrix of his estate. The will was duly admitted to probate in the Surrogate's Court for Monroe County, New York and Anna Vatter duly qualified as executrix. The Genesee Valley Union Trust Company was nominated by decedent's will, and it qualified as trustee of a testamentary trust to which decedent bequeathed and devised the "rest, residue and remainder" of his estate. (R. 68-69.)

1/ The Commissioner determined a deficiency in federal estate taxes in the amount of $517.40. (R. 10.)

2/ "R." references are to the separately bound record appendix.

Decedent's will, in pertinent part, provided as follows (R. 62-64):

> FIRST. I direct that all my just debts and furneral expenses be paid as soon after my decease as may be practicable, except that the payment of any debt secured by a mortgage or pledge of real or personal property may be postponed by the Executors in their discretion.
>
> SECOND. If my wife, Anna Vatter, survives me, I give and bequeath to her all of my household goods, furniture, furnishings, works of art, personal effects, jewelry, and cars.
>
> THIRD. If my wife, Anna, survives me, I give and bequeath to her absolutely and forever, an anount equal to the maximum estate tax marital deduction allowable in determining the Federal estate tax on my estate for Federal estate tax purposes * * *. * * * the Executors shall first allot to this gift and bequest the more liquid and salable assets of my estate * * *.
>
> FOURTH. All the rest, residue and remainder of my property I give, devise and bequeath to my Trustee hereinafter named, in trust nevertheless for the following uses:
>
> > My trustee shall hold, invest and reinvest same in accordance with the terms hereof * * * and * * * shall pay all of the net income from the said trust to my wife * * *.
> >
> > The Trustee shall invest and reinvest any funds in my estate or in any trust created herein in such investments as they, in their discretion, may deem advisable * * * as they would possess if they were the absolute owners of the property held by them under this Will.
> >
> > Upon the death of my wife, Anna Vatter, the principal then remaining in the trust * * * shall be paid over to each of my children * * *. If at the decease of my wife, Anna Vatter, My Trustee retained in this trust any real property or any property

> of any specific nature other than cash, the Trustee is to be allowed to turn over to such child according to their desires, any property which it holds title to * * *
>
> * * *
>
> SEVENTH. All Estate, inheritance, transfer, legacy or succession taxes, or death duties * * * shall be paid out of my residuary estate as an expense of administration * * *
>
> EIGHTH. I give to my Executor and Trustee the following powers, in addition to and not in limitation of his common law and statutory powers:
>
> To sell, at public or private sale, for cash or on credit, and upon such terms as they may deem proper, any property at any time held by them. * * *
>
> To manage any real property held by them in such manner as they may determine * * *.
>
> To lease any real property that may be included in my estate or any trust created herein * * *.
>
> LASTLY. I hereby nominate and appoint my wife, ANNA VATTER Executrix of this my last WILL AND TESTAMENT * * * I hereby nominate and appoint the GENESEE VALLEY UNION TRUST COMPANY as Trustee * * *.
>
> * * *

A substantial portion of Joseph Vatter's residuary estate consisted of three parcels of improved real estate which had been acquired by him at bank foreclosure sales during the years 1935 to 1940. (R. 25, 58, 69.) At the time of his death, all of the properties were rental properties: 261 Melville Street, a single family dwelling; 367 Pullman Avenue, a four-family dwelling; and 783-785 Arnett Boulevard, a two-family dwelling.

Due to the age and condition of the properties, the Genesee Valley Union Trust Company did not desire to have these three parcels of real estate turned over to it as trustee under paragraph FOURTH of decedent's will. (R. 25-26, 72.) Consequently, the trust company requested the executrix to sell them. Pursuant to the power of sale granted to her in paragraph EIGHTH of decedent's will, the executrix sold each of the properties, incurring the following selling expenses (R. 70):

261 Melville Street		
Closing costs	$ 620.00	
Real estate commissions	750.00	
Total:		$1,370.00
367 Pullman Avenue		
Closing costs	283.61	
Expenses for compliance with multiple residence laws	702.07	
Real estate commissions	1,230.00	
Total:		$2,415.68
783-85 Arnett Boulevard		
Closing costs	1,039.00	
Real estate commissions	1,188.00	
Total:		$2,227.00
Total selling expenses[3/] (all three parcels)		$6,012.68

Conveyance of all three properties was made by executor's deed. The dates of sale, and the gross and net proceeds from each sale were as follows (R. 70):

Property	Date	Gross	Net
Melville St.	April 1, 1969	$12,500.00	$11,130.00
Pullman Ave.	March 28, 1969	20,500.00	18,084.32
Arnett Blvd.	June 10, 1969	19,800.00	17,573.00

3/ The parties stipulated that these expenses were reasonable in amount. (R. 24.)

The cash needs of decedent's estate were as follows for the purposes set forth below (R. 71):

Funeral expenses	$1,633.50	
Attorney's fees	6,200.00	
Guardian's fees	200.00	
Federal taxes	7,123.87	
State taxes	2,500.00	
		$17,657.37
Specific bequest to wife:		
Adjusted marital deduction	$110,842.46	
Less value of property passing to spouse outside of will or otherwise	(103,851.19)	
		$ 6,991.27
Total cash needs of estate for purposes set forth above		$24,648.64

To meet these cash needs of $24,648.64, $21,029.22 was available from the proceeds of an annuity which the estate received around July 11, 1968, shortly after decedent's death. (R. 24, 71.) The remaining cash needs of $3,619.42 were satisfied from the proceeds from the sale of the realty.

At the time the Tax Court delivered its opinion in this case, no accounting, either interim or final, had been filed with the Surrogate's Court. It was stipulated that when such accounting is filed, the executrix intends to claim the expenses of selling the three properties as expenses of administration under New York Surrogate's Court Procedure Act (SCPA), Article 22

(McKinney 1967), and New York Estates, Powers and Trust Law (EPT) Sections 11-1(b)(5) and 13-1.3(a)(1) (McKinney 1967). (R. 24-25, 73.)

A federal estate tax return was filed with respect to the Estate of Joseph Vatter on July 24, 1969. (R. 27-61.) On Schedule J of this return, the executrix claimed a deduction for all selling expenses with respect to the three rental properties. (R. 53.) Upon audit, the Commissioner allowed the $1,370.00 selling expenses of the Melville Street property as a deduction for administration expenses, because the sale was necessary to satisfy the $3,619.42 cash needs of the estate over and above the $21,029.22 cash annuity received during July, 1968. The Commissioner, however, disallowed selling expenses in the amount of $4,642.68 pertaining to the sale of the realty at 367 Pullman Avenue and at 783-785 Arnett Boulevard, on the grounds that these expenses did not constitute administration expenses under Section 2053(a) of the Internal Revenue Code of 1954. (R. 12.)

In rejecting the Commissioner's determination, the Tax Court held that the selling expenses were deductible as administration expenses, reasoning that the testamentary trustee's refusal to accept the properties in kind made it "necessary for the executrix to sell the rental real estate * * * to effect the distribution of the residuary estate to the testamentary trust." (R. 80.) The Commissioner appeals from this ruling.

SUMMARY OF ARGUMENT

The issue on appeal is whether the estate may deduct as administration expenses under Section 2053(a) of the Internal Revenue Code of 1954 and the Regulations thereunder the expenses of selling the Arnett Boulevard and Pullman Avenue rental properties. This Court's recent decision in Estate of Smith v. Commissioner, 510 F. 2d 479 (1975), cert. denied, sub nom. Lowe v. Commissioner, 423 U.S. 827 (1975), dealing with a comparable fact situation, establishes that it cannot.

Section 2053(a) allows a deduction, in computing the estate subject to tax, for "administration expenses * * * as are allowable by the laws of the jurisdiction * * * under which the estate is being administered." The Treasury Regulations defining the term "administration expenses" generally limit the deduction to expenses necessarily incurred in the proper settlement of the estate. The expenses of selling the property of the estate are also dealt with by the Regulations. Such expenses are not deductible unless the sale is necessary to pay the debts of the decedent, administration expenses, or taxes, to preserve the estate, or to effect distribution.

Here, as in Estate of Smith, the Commissioner allowed the estate an administration expense deduction sufficient to pay the decedent's debts, the expenses of administration, and taxes. The parties stipulated that the total cash need of the estate for these purposes was $24,648.64, most of which was available from the proceeds of the $21,029.22 cash annuity received by the estate

shortly after decedent's death. Thus, after the sale of the Melville Street property, the estate had sufficient cash to pay all of its debts and taxes, and the other two sales--which produced a cash surplus of over $35,000--were clearly not necessary to settle the estate.

Nor was there any need for the estate to sell the two properties to effect distribution, as the Tax Court erroneously concluded. Decedent's will--like the will in Estate of Smith--contemplated an in-kind distribution of the properties to the testamentary trust as part of the residuary bequest. Although the executrix had a power of sale, that power was limited under New York law to sales necessary to fulfill her obligations as executrix under the will; that is, to pay debts, expenses, and taxes. Sales beyond these needs were made on behalf of the trust, and hence the expenses of such sales are not deductible. Indeed, the Tax Court's own finding that the rental properties were sold because the trustee did not desire to have them turned over to it to manage as the corpus of the testamentary trust clearly shows that the sales were incurred for the trustee's benefit and convenience--just as the additional sales of sculpture in Estate of Smith were incurred for the benefit of Smith's daughters. In short, the Tax Court misapplied both the Regulations and this Court's controlling decision in Estate of Smith in concluding that the expenditures were deductible as administration expenses.

Moreover, despite the fact that no local court has approved the instant expenditures, the Tax Court simply assumed that they were allowable administration expenses under New York law, and failed to conduct a de novo inquiry into the basis upon which deductibility depends as mandated by this Court's decision in Estate of Smith. A close examination of New York law indicates that these sales expenses are clearly trust administration expenses and not estate administration expenses and, hence, not the type intended to be deductible under the federal statute.

The decision below is erroneous, and should be reversed.

ARGUMENT

THE TAX COURT ERRED IN CONCLUDING THAT THE REAL ESTATE COMMISSIONS AND EXPENSES PAID ON THE SALES OF THE ARNETT BOULEVARD AND PULLMAN AVENUE RENTAL PROPERTIES WERE DEDUCTIBLE AS ADMINISTRATION EXPENSES, SINCE THE EXPENDITURES WERE NOT NECESSARY TO SETTLE THE ESTATE WITHIN THE MEANING OF SECTION 2053 OF THE INTERNAL REVENUE CODE OF 1954 AND THE REGULATIONS THEREUNDER

A. The additional two sales were not necessary under the Regulations to pay debts, taxes, or to effect distribution of the residuary bequest

The issue on appeal is whether the expenses of selling the two improved parcels of real estate that comprised the major portion of the corpus of the testamentary trust are deductible as administration expenses under Section 2053(a) of the Internal Revenue Code of 1954, Appendix, infra. The controversy centers on Judge Forrester's conclusion that the testamentary trustee's refusal to accept the two parcels in kind made it necessary for the executrix to sell the properties in order to distribute the residuary estate to the testamentary trust. It is the Commissioner's position in the instant case that the Tax Court erred in allowing these selling expenses as administration expenses. As demonstrated below, the court's ruling is not only contrary to Section 2053(a) and its underlying Regulations, but is also inconsistent with the concept of an estate administration expense under New York law.

Section 2053(a) of the Internal Revenue Code of 1954, allows a deduction, in computing the value of the estate subject to tax, for "administration expenses * * * as are allowable by the laws of the jurisdiction * * * under which the estate is being administered." The Code does not define the term "administration expense," but the Regulations provide that deductible expenses are those which are necessarily incurred in the proper settlement of the estate and not those incurred for the individual benefit of the beneficiaries of the estate. Section 20.2053-3(a), Treasury Regulations on Estate Tax (1954 Code), Appendix, infra, provides:

> The amounts deductible from a decedent's gross estate as "administration expenses" * * * are limited to such expenses as are actually and necessarily incurred in the administration of the decedent's estate; that is, in the collection of assets, payment of debts, and distribution of property to the persons entitled to it. The expenses contemplated in the law are such only as attend the settlement of an estate and the transfer of the property of the estate to individual beneficiaries or to a trustee, whether the trustee is the executor or some other person. Expenditures not essential to the proper settlement of the estate, but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions.

The deductibility of selling expenses is further elaborated upon in Regulations Section 20.2053-3(d)(2), Appendix, infra:

> Expenses for selling property of the estate are deductible if the sale is necessary in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution.

Thus, to be deductible, as this Court stated in Estate of Smith v. Commissioner, 510 F. 2d 479 (1975), cert. denied, sub nom. Lowe v. Commissioner, 423 U.S. 827 (1975), an administration expense (510 F. 2d, p. 482, fn 4):

> * * * must be the "type intended to be deductible" (United States v. Stapf, 375 U.S. 118, 130 * * * (1964)), ultimately a question of federal law. See Pitner v. United States, 388 F. 2d 651 (5 Cir. 1967). 4/

In Estate of Smith v. Commissioner, 57 T.C. 650 (1972), the decedent was a sculptor who died possessed of 425 pieces of valuable sculpture which he had created. The will bequeathed the residuary estate, including all of the sculpture, to a testamentary trust for the benefit of Smith's daughters. And, as with the will in the instant case, (R. 64), the Smith will gave both the executors and trustees the power to sell the property of the estate as they saw fit. It provided, in relevant part (57 T.C., p. 654):

> THIRD: My Executors and Trustees shall take possession of my estate and are hereby given power to hold, manage, operate, control, sell, convey, lease, * * * and to mortgage and encumber such parts of my property and estate, real or personal, including all of my works of art, as in their best judgment and discretion may be expedient.

4/ Taxpayer argued below that Regulations Section 20.2053-3(d)(2) was invalid, relying on the Sixth Circuit's decision in Estate of Park v. Commissioner, 475 F. 2d 673 (1973). Unlike Park however, the decision below (R. 78)--like this Court's decision in Estate of Smith, supra, p. 483--did not reach the question of the validity of the regulation. Further, while we submit that in any event Park was wrongly decided, that case is factually distinguishable from the instant case, since in Park the Sixth Circuit placed major reliance on the fact that the expenses were allowed by the Michigan probate court (475 F. 2d, p. 676), while in the instant case the expenditures have yet to be submitted for approval to the New York Surrogate's Court. (R. 73.)

The executors claimed an administration expense deduction in the amount of $1,583,544.67 for sales commissions of Smith's work, an amount which was approved by the Surrogate's Court. The Tax Court, however, allowed the estate only $750,447.74 as a deduction for sales commissions under Section 2053(a), a sum representing the "exact amount necessary to pay the decedent's debts, the expenses of administration, and the taxes finally adjudicated." 510 F. 2d, p. 481. In disallowing the unnecessary sale expenses, the Tax Court, in a reviewed opinion, held that to the extent the executors incurred commissions to sell the sculpture in excess of the $750,447.74 amount, "they were acting on behalf of the trust and not on behalf of the estate." 57 T.C., p. 661. Judge Forrester, the Judge who decided the instant case, was among those dissenting in Estate of Smith.

In affirming Estate of Smith on appeal, this Court held that the federal courts are not precluded from a "de novo inquiry into the factual necessity" for administration expenses. Judge Anderson stated (510 F. 2d, p. 482-483):

> In the present case, appellants' claims for administration expenses were not contested in the Surrogate's Court and there is some question as to whether some of these expenses were in fact incurred for the benefit of the estate in accordance with the general purpose of § 2053 rather than for the benefit of individual beneficiaries. * * * In such circumstances, the federal courts cannot be precluded from reexamining a lower state court's allowance of administration expenses to determine whether they were in fact necessary to carry out the administration of the estate or merely prudent or advisable in preserving the interests of the beneficiaries.

This Court's reasoning in Estate of Smith is equally applicable to the situation in the instant case. Indeed, the need for a de novo review of the facts in light of federal law is even stronger here than in Estate of Smith, since unlike Smith --where the selling expenses were approved by the Surrogate's Court in an uncontested proceeding--Mrs. Vatter's claims for administration expenses had not even been submitted to the Surrogate's Court for approval at the time the Tax Court delivered its opinion. (R. 73.)

And just as in Smith, there was no necessity here to sell the properties beyond the point necessary to discharge taxes, fees, funeral expenses and the marital bequest.[5/] 510 F. 2d, pp. 482-483. The parties stipulated that the total cash need of the estate for these purposes was $24,648.64, most of which was available from the proceeds of the $21,029.22 cash annuity received by the estate shortly after decedent's death. (R. 24, 71.) This left only $3,619.42 to be raised by the estate, which was more than satisfied by the $11,130 net proceeds from the sale of the Melville Street rental property.[6/] In short, after the sale of one piece of property the estate had sufficient

5/ The will specifically directed the executors to satisfy the marital deduction bequest with the "more liquid and salable assets of * * * [decedent's] estate." (R. 62.)

6/ The Commissioner allowed the entire amount of the selling expenses for the Melville Street property, even though the sale generated a cash surplus of $7,515.68.

cash to pay all of its debts and taxes. Indeed, the remaining proceeds from the sale of the Melville Street property together with the net proceeds from the other two properties produced a cash surplus for the estate in the amount of $43,173.32. Thus, there was clearly no necessity for the estate to sell the Pullman Avenue and Arnett Boulevard properties to settle the estate. It therefore follows that the expenses of selling these properties were not deductible as administration expenses under Regulations Section 20.2053-3(d)(2).

Ignoring the foregoing, Judge Forrester attempted to save the instant expenses from disallowance by erroneously reasoning that the testamentary trustee's refusal to accept the rental properties in kind made it necessary for the executrix to sell the properties in order to distribute the residuary estate. He stated (R. 79-80):

> The trustee did not wish to accept as trust property the rental real estate which comprised a substantial portion of the decedent's residuary estate. Thus, in order for the residuary estate to be distributed to the trustee named in decedent's will, it was necessary for the executrix to sell the rental real estate. Therefore, the selling expenses were necessarily incurred to effect the distribution of the residuary estate to the testamentary trust within the meaning of section 20.2053-3(d)(2), Estate Tax Regs.

Judge Forrester's interpretation of "necessity" in effect reads this requirement out of the Regulations, and is incorrect as a matter of law. The Regulations unequivocally provide that

expenditures not essential to the proper settlement of the estate, "but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions." Regulations, § 20.2053-3(a). See Estate of Smith v. Commissioner, 510 F. 2d, pp. 482-483. Here, after the sale of the Melville Street Property, the estate had sufficient cash to pay all of its debts and taxes. Under these circumstances, any further sales must necessarily have been for the benefit of the surviving heirs. Indeed, the Tax Court's own findings (R. 72) that the properties were sold because the "trustee did not desire to have the rental properties turned over to it to manage as the corpus of the testamentary trust" clearly shows that the sales were incurred for the trustee's benefit and convenience--just as the additional sales of sculpture in Smith were incurred for the benefit of Smith's daughters. 57 T.C., p. 661. As the Third Circuit said in Sharpe's Estate v. Commissioner, 148 F. 2d 179, 181 (1945):

> * * * the carrying on of the trust is a different enterprise, not in settlement of a dead man's affairs, but for the benefit of the beneficiaries of the trust. It operates to continue the affairs of the living, not to close up those of the departed.

Cf. Estate of Streeter v. Commissioner, 491 F. 2d 375 (en banc) (C.A. 3, 1974). See also Estate of Peckham v. Commissioner, 19 B.T.A. 1020 (1930), where the Board of Tax Appeals refused

to allow any deduction for the expenses of maintaining the estate beyond the ordinary period of administration because it found that after such time the executors were in fact holding the assets as trustees. Similarly, here, where the real estate sales were made and the sales expenses were incurred at the trustee's instigation, there is no question that the expenditures were incurred solely for the benefit of the beneficiaries of the trust, and were not necessary to settle the estate. Accordingly, we submit that the sales expenses were not "administration expenses" of the estate within the meaning of Section 2053(a) and the Regulations thereunder.

In a similar vein, New York law has long recognized that a person nominally acting as an executor may in fact be performing the functions of a trustee. Standards for distinguishing between these two roles were enunciated as early as 1851. Drake v. Price, 5 N.Y. 430 (1851) (Judge Paige dissenting, subsequently approved by the court in Hurlburt v. Durant, 88 N.Y. 121 (1882), and Johnson v. Lawrence, 95 N.Y. 154 (1884)) (5 N.Y., p. 432):

> The office of an executor is * * * to collect the outstanding debt and sell the goods and chattels so far as is necessary to the payment of the debts and legacies * * * If any other duty is imposed upon the executor, or any power conferred, not appertaining to the duties above enumerated, a trust, or trust power is created, and the executor becomes a trustee * * *

See I Scott on Trusts (3d ed.) § 6, p. 58 and fn 5. Thus, under New York law, the expenditures here were clearly incurred by the executrix in her fiduciary capacity acting as a "trustee," since there was no need to sell the properties to pay the debts and legacies of the estate. Although Judge Forrester may well been correct in his belief that "the selling expenses are allowable administration expenses under New York law" (R. 78)--See New York Estates, Powers and Trusts Law (EPTL) § 11-1.1(b)(5) and (23) (McKinney 1967)--he failed to take the critical next step in the analysis to consider the point that these expenses would be allowable as trust administration expenses and not as estate administration expenses.[7/]

Indeed, under New York law, title to the real property here passed directly to the residuary trust without any act on the part of the executrix, subject only to the power of sale to pay debts and expenses of the estate. As the

7/ The reviewer's notes and Practice Commentary indicate that EPTL § 11-1.1(b)(23) was intended to incorporate the substance of § 222 of the Surrogate's Court Act, which was in effect when this Court decided Estate of Smith, 510 F. 2d, p. 481. See 26 Carmody-Wait 2d, § 159.44; Matter of Rosenberg, 169 Misc. 92, 6 N.Y.S. 2d 1009 (Sur. Ct., 1938). Thus, Judge Forrester's statement (R. 78, fn 5) that the expenses of selling the real property "would be allowable administration expenses under New York law even if not necessary within the meaning of sec. 20.2053-3, Estate Tax Regs." is correct only as to trust administration expenses, but not as to estate administration expenses, because the prior law pertaining to the "expenses of administration necessarily incurred by" executors is incorporated in EPTL § 11-1.1(b)(23) (Renumbered as of June 22, 1973 as 11-1.1(b)(22)) (McKinney 1967). See Matter of Tenney, 74 Misc. 2d 552, 345 N.Y.S. 2d 406 (Sur. Ct., 1973). See also Surrogate's Court Procedure Act, § 2307-1 (McKinney 1967), empowering the surrogate to allow only "reasonable and necessary expenses actually paid" by the executrix on the settlement of the account.

Surrogate's Court stated in Matter of Tenney, 74 Misc. 2d 552, 554, 345 N.Y.S. 2d 406, 408 (1973):

> Under decedent's will, title to decedent's real property passed under the residuary clause directly to the sole residuary beneficiary without any act on the part of the executor, Matter of Salomon, 252 N.Y. 381, 169 N.E. 616, supra. The beneficiary thereby had title subject only to the power of sale in the executor if there should be a need to exercise the power for any estate need. Here there was no need as personal assets were ample to pay all debts and expenses.

This same court also concluded that there was no need for the executor to sell property to effect distribution where, as here, there was but a single residuary beneficiary. (74 Misc. 2d, p. 554, 345 N.Y.S. 2d, p. 408):

> Nor was there any need to sell for distribution to avoid partition because there was but a single residuary beneficiary.

See also In re Zehe's Will, 57 N.Y.S. 2d 574, 577-578 (Sur. Ct., 1945); In re Argento's Will, 33 Misc. 2d 969, 228 N.Y.S. 2d 47 (Sur. Ct., 1962). Cf. Estate of Carson v. Commissioner, P-H Memo T.C., par. 76,073 (1976), where the Tax Court, in disallowing real estate selling expenses for a residence, rejected the estate's argument that the sale was necessary to effect distribution. The Tax Court noted that the house had already vested in the intended beneficiary by operation of Illinois law, and that the decision to sell reflected the beneficiary's "personal judgment about the management of her own property." Estate of Carson, supra, p. 76-327. This same reasoning is applicable to disallow the instant expenditures, since under New York law the rental properties vested automatically

in the trust, subject only to the power of sale to raise cash necessary to settle the estate. Matter of Tenney, supra. As in Carson, the sales here were not necessary to effect distribution, but simply reflected the judgment of the trustee about the management of its own property.

Thus, the fact that paragraph EIGHTH (R. 64) of decedent's will--like paragraph THIRD of the will in Estate of Smith, 57 T.C., p. 654--gave both the executrix and the trustee a seemingly co-extensive power of sale is clearly not controlling. The executrix could exercise this power only to the extent necessary to achieve her limited obligations under paragraphs FIRST, THIRD, and SEVENTH--namely to pay debts, funeral expenses, fees, taxes and the marital bequest. (R. 62-64.) To the extent she engaged in additional activities with respect to the power of sale, she was acting on behalf of the beneficiaries and not the estate under both federal law and New York law. Sharpe's Estate v. Commissionar, supra; Regulations Sections 20.2053-3(a) and 20.2053-3(d)(2); Matter of Tenney, supra.

Accordingly, Judge Forrester's reliance on Estate of Sternberger v. Commissioner,[8/] 18 T.C. 836 (1952), aff'd,

8/ In Sternberger, the decedent's will allowed his spouse and daughter to occupy his residence, but they chose to live elsewhere and the property was sold. Although the opinion does mention that the proceeds of sale were not needed to pay debts or expenses of the estate, 18 T.C., p. 842, the Tax Court in Sternberger was not called upon to decide the critical question whether the sale was carried out for the purpose of administering the estate.

207 F. 2d 600 (C.A. 2, 1953), rev'd on other grounds, 348 U.S. 187 (1955), is misplaced and his conclusion that "the controlling fact is that the executrix [and not the trustee] actually sold the real estate" (R. 76) is wide of the mark, since the executrix here sold the property on behalf of the trustee.[9/]

B. The Tax Court misapplied the controlling federal court decisions and misinterpreted decedent's will in concluding that the expenditures were deductible as administration expenses

It is thus clear that the Tax Court's conclusion that the expenses of selling the Arnett Boulevard and Pullman Avenue rental properties are deductible as administration expenses is based upon a mistaken view of Section 2053(a) and the Regulations thereunder. In addition, the Tax Court in reaching its decision not only misinterpreted decedent's will, but also erred in its attempt to distinguish Estate of

9/ Insofar as Sternberger may be read as treating allowability of an expense under state law, 18 T.C., pp. 842-843, as the sole determinant for estate tax deductibility, it was overruled by this Court's decision in Estate of Smith v. Commissioner, supra, pp. 482-483, fn 4, citing with approval and following the Fifth Circuit's holding in Pitner v. United States, 388 F. 2d 651, 659 (1967) that an administration expense must be the type intended to be deductible by federal law.

Smith, supra, and Estate of Swayne v. Commissioner, 43 T.C. 190 (1964). Judge Forrester stated (R. 77):

> In Swayne the real property sold (the decedent's residence) was specifically devised, and the proceeds from its sale were not part of the residuary estate. 43 T.C. at 193, 201. In Smith, the will contemplated a distribution to testamentary trusts of property (sculptures) in kind, and the sales of the sculptures were consummated on behalf of the trusts. 57 T.C. at 661. In the instant case, the real property was neither specifically devised nor intended to be distributed in kind.

We submit that this reasoning is faulty. In the first place, the question whether or not property is specifically devised in a will is simply irrelevant to the issue at bar--namely, whether the properties were sold to settle the estate. And second, the Tax Court's statement that the real property here was not intended to be distributed in kind is clearly a misinterpretation of decedent's will. A close examination of the will indicates that the Vatter will, like the will in Smith, 57 T.C., p. 661, did contemplate an in kind distribution of the rental properties to the trust. Specifically, the will devised "All the rest, residue and remainder" of the estate to the trust (R. 62), and from the Tax Court's own findings (R. 79), the rental real estate comprised "a substantial portion of the decedent's residuary estate." Moreover, the will goes on to give the trustee powers to sell, manage, and "lease any real property that may be included in my estate or any trust created herein" (R. 64), and upon the death of decedent's wife, each of decedent's

children had the right to select in kind any real property retained in the trust (R. 63).

Also, the real estate in Estate of Swayne, supra, was not "specifically devised" as Judge Forrester mistakenly indicated in his opinion (R. 77), but was part of a residuary bequest similar to paragraph FOURTH in the instant will (R. 62-63). There were two wills in Swayne, and the will referred to by Judge Forrester was ultimately denied probate as the result of a will compromise agreement, the second will being the one admitted to probate. 43 T.C., pp. 190-197. In Swayne, the estate sought an administration expense deduction for expenses incurred in connection with the sale of the decedent's personal residence. Despite the fact that the local probate court had authorized the sale of the residence, the Tax Court in Swayne denied the deduction, noting that the application for sale was not opposed, and that the taxpayer offered no evidence "sufficient to establish that the sale of the residence was necessary to pay decedent's debts, the expenses of administration, or taxes, preserve the estate or effect distribution." 43 T.C., p. 201. In short, it is clear that the facts in the instant case do not differ in any material respect from those in Smith and Swayne, and that the Tax Court's decision here is inconsistent with those two prior decisions.

Nor is there any merit to the Tax Court's attempt to distinguish Smith on the grounds that the Tax Court there "made a factual determination that the selling expenses were not allowable administration expenses under New York law." (R. 77-78.) New

York Estates, Powers and Trusts Law (EPTL) § 11-1.1(b)(5) and (23) (McKinney 1967). On the contrary, the Tax Court in Smith found that the expenses had been allowed by the New York surrogate, and the majority opinion assumed that the expenses were allowable under New York law. 57 T.C., pp. 654, 660-661. Moreover, this Court in affirming Smith made it clear that federal estate tax results are not conclusively determined by a surrogate's determination that expenses are allowable under local law. A surrogate's determination--absent in the instant case--does no more than meet the threshold requirement for deductibility and does not resolve the further federal question of the expenditures being "necessary." Cf. Regulations Section 20-2053-1(b)(2) (Effect of court decree), Appendix, infra. As this Court stated in Estate of Smith (510 F. 2d, p. 483):

> Viewed from this standpoint, the Tax Court's determination that the additional sales of sculpture were not necessary to preserve the estate or to effect its distribution did not involve a refusal to follow New York law, but rather was the result of a de novo inquiry into the factual necessity for these expenditures.

The need for a de novo inquiry into the factual necessity for the instant expenditures is especially compelling since no local court has allowed the expenses. Here the only evidence in the record as to the factual necessity of the expenses is the parties' stipulated statements that the sales were not necessary to raise cash for the estate (R. 23-24), and that the executrix sold the properties at the trustee's request because it "did not desire to have the * * * properties turned over to it as trustee"

(R. 25). We submit that these facts demonstrate the lack of necessity for the expenditures, and show that the estate here failed to meet its burden of proving that the Commissioner's determination was invalid. Estate of Swayne v. Commissioner, 43 T.C., p. 201.

In sum, even though the expenses in issue here may be allowable under New York law as "administration expenses," this would be in the context of trust administration expenses, and hence, clearly not the "type intended to be deductible" under the federal statute. United States v. Stapf, 375 U.S. 118, 130 (1963).

CONCLUSION

For the foregoing reasons, the decision of the Tax Court should be reversed and judgment entered for the Commissioner.

Respectfully submitted,

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CERTIFICATE OF SERVICE

It is hereby certified that service of this brief has been made on opposing counsel by mailing four copies thereof on this 22d day of July, 1976, in an envelope, with postage prepaid, properly addressed to him as follows:

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APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 2053. EXPENSES, INDEBTEDNESS, AND TAXES.

(a) General Rule.--For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts--

(1) for funeral expenses,

(2) for administration expenses,

(3) for claims against the estate, and

(4) for unpaid mortgages on, or any indebtedness in respect of, property where the value of the decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate,

as are allowable by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered.

* * *

Treasury Regultions on Estate Tax (1954 Code) (26 C.F.R.):

§ 20.2053-1 Deductions for expenses, indebtedness, and taxes; in general.

* * *

(b) Provisions applicable to both categories--* * *

(2) Effect of court decree. The decision of a local court as to the amount and allowability under local law of a claim or administration expense will ordinarily be accepted if the court passes upon the facts upon which deductibility depends. If the court does not pass upon those facts, its decree will, of course, not be followed. For example, if the question before the court is whether a claim should be allowed, the decree allowing it will ordinarily be accepted as establishing the validity and amount of the claim. However, the decree will not necessarily be accepted even though it purports to decide the facts upon which deductibility depends. It must appear

that the court actually passed upon the merits of the claim. This will be presumed in all cases of an active and genuine contest. If the result reached appears to be unreasonable, this is some evidence that there was not such a contest, but it may be rebutted by proof to the contrary. If the decree was rendered by consent, it will be accepted, provided the consent was a bona fide recognition of the validity of the claim (and not a mere cloak for a gift) and was accepted by the court as satisfactory evidence upon the merits. It will be presumed that the consent was of this character, and was so accepted, if given by all parties having an interest adverse to the claimant. The decree will not be accepted if it is at variance with the law of the State; as, for example, an allowance made to an executor in excess of that prescribed by statute. On the other hand, a deduction for the amount of a bona fide indebtedness of the decedent, or of a reasonable expense of administration, will not be denied because no court decree has been entered if the amount would be allowable under local law.

* * *

§ 20.2053-3 Deduction for expenses of administering estate.

(a) In general. The amounts deductible from a decedent's gross estate as "administration expenses" of the first category (see paragraphs (a) and (c) of § 20.2053-1) are limited to such expenses as are actually and necessarily incurred in the administration of the decedent's estate; that is, in the collection of assets, payment of debts, and distribution of property to the persons entitled to it. The expenses contemplated in the law are such only as attend the settlement of an estate and the transfer of the property of the estate to individual beneficiaries or to a trustee, whether the trustee is the executor or some other person. Expenditures not essential to the proper settlement of the estate, but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions.
* * *

* * *

(d) Miscellaneous administration expenses.
* * *

(2) Expenses for selling property of the estate are deductible if the sale is necessary in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution. * * *